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# FINANCIAL MARKETS LAW COMMITTEE

## ISSUE 129: EUROPEAN ACCOUNT PRESERVATION ORDER

**Observations on legal uncertainty arising from the Proposal for a European Account Preservation Order**


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**FINANCIAL MARKETS LAW COMMITTEE**

**ISSUE 129 WORKING GROUP**

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## 1. INTRODUCTION

1.1. The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks and to consider how such issues should be addressed.

1.2. The European Commission ("the Commission") adopted a proposal for a Regulation ("the Proposed Regulation") creating European Account Preservation Orders ("EAPOs") to facilitate cross-border debt recovery in civil and commercial matters on 25 July 2011.[1] The FMLC previously published a letter which examined issues of legal uncertainty arising from the Proposal, on 19 September 2011.[2] Many of the considerations set out in the FMLC's previous letter on this topic remain salient.

1.3. HM Government launched a consultation which raised the question of whether the UK should opt in to the EAPO Proposal. HM Government announced its intention not to opt in on 31 October 2011 but has participated in negotiations with a view to opting in at a later date.[3] In the course of co-decision, draft texts have been prepared by the Council of the European Union ("the Council"); one text is the Presidency Compromise Text. The Presidency Compromise Text was released to the FMLC in the context of an informal consultation launched by the Ministry of Justice in 2012. This paper highlights key areas of legal uncertainty arising from the Presidency Compromise Text, which may currently be the subject of discussion in the Council.

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1 Available here.

2 This letter is available at www.fmlc.org/Pages/papers.aspx. Notably, the FMLC made the point in its previous letter that legal uncertainty arises from the possibility that prior charges and negative pledges may be displaced by an EAPO because, unlike current UK freezing orders, an EAPO would take effect *in rem* (i.e. in a way similar to a fixed charge). The FMLC maintains this concern, notwithstanding arguments to the contrary which the Committee understands have been made.

3 HM Government's written statement.

## 2. BACKGROUND

2.1. The aim of the Proposed Regulation is to establish a free-standing European procedure for a protective measure to freeze the bank accounts of defendants in cases which have cross-border implications. If implemented, the Proposed Regulation will enable a claimant to make a single application to the courts of one Member State to obtain an order which will "freeze" monies that a defendant holds in bank accounts in other Member States, without further intervention by the courts in those jurisdictions. It is intended that this procedure will decrease the "cumbersome, lengthy and costly" implications associated with obtaining an order to preserve a debtor's assets located abroad.[4]

2.2. The Proposed Regulation introduces a standardised application process to obtain an EAPO and is intended to enable creditors to obtain such orders on the basis of the same conditions irrespective of the country where the competent court is located. The Proposed Regulation, therefore, represents a departure from the approach that applies in the EU to other *ex parte* orders such as asset protection orders, since these orders are often not enforceable in other Member States. Provisional measures issued without a prior hearing of the debtor are not recognised and enforced under the Brussels I Regulation according to the jurisprudence of the European Court of Justice.[5] (And so, for example, to obtain a series of asset protection orders for a defendant's bank accounts held in other countries within the EU, the claimant will usually have to make a series of individual applications to the courts of each Member State in which the defendant holds a bank account.)

## 3. PRE-INSOLVENCY AND INSOLVENCY SITUATIONS

3.3. It is not for the FMLC to question the policy underlying the Proposal. The Proposed Regulation and Presidency Compromise Text may raise some serious uncertainties for financial market participants. One such uncertainty arises in connection with Article 2. This article stipulates that the Regulation shall not apply, *inter alia*, to "bankruptcy and proceedings relating to the

[4] See the "Explanatory Memorandum" in the Proposed Regulation, at paragraph 1.2.

[5] See section on "Legal Elements of the Proposal" in the Proposed Regulation, page 5, at paragraph 3.1.1.

winding-up of insolvent companies or other legal persons". In the absence of further guidance, it is not clear whether the Proposed Regulation is thereby immediately disapplied once insolvency proceedings concerning the debtor have been opened notwithstanding an application for an EAPO may already be in progress or an EAPO in fora. Nor is it entirely clear whether the Proposed Regulation is available to an insolvency practitioner seeking to recover detrimental payments made by the debtor to third parties as an incidental aspect of the administration of the debtor's estate. It is unfortunate that the Proposed Regulation does not set out expressly whether or not it applies in those situations. The FMLC has been given to understand that the scope of the carve-out outlined in Article 2 may be clarified in a recital in a further revised text prepared by the Council.

3.4. Another point of uncertainty arises in the context of restructuring procedures. Article 2 of the Presidency Compromise Text does not provide a carve-out for companies in formal or informal restructurings (short of insolvency). Considerable uncertainty may arise in circumstances where a company is in financial difficulty, but has not yet formally entered into an insolvency procedure. If an EAPO were to be served on a company short of insolvency, this may have a detrimental effect on a company's planned restructuring. It is noted that the threshold test in Article 7 (considered below, at paragraph 4.1. of this paper) may, to some extent, mitigate this problem.

3.5. As a further matter, the FMLC has been asked to consider the interaction of the choice of law rule in the context of restructurings. One possible solution which the FMLC has been asked to examine is the insertion of a new article which provides that the law of domicile would apply in cases of restructurings. If the law of the domicile prevented asset protection orders or equivalent measures being granted (or required them to be stayed), those provisions would also apply to stay an EAPO.

3.6. It is difficult to ascertain whether "domicile" refers to the location of the company or the location in which the relevant bank account is situated. If the

location of the company is the intended meaning, it is not clear how the test would interact with the "Centre of Main Interest" test under the EU Regulation on Insolvency Proceedings.[6] The Centre of Main Interest test outlines the rules for deciding where main insolvency proceedings can be opened in situations where a company is located in two or more Member States. On the other hand, if the location of the account is the intended meaning of "domicile" there will be considerable complexity in circumstances where a company has bank accounts in multiple jurisdictions.

## 4. THRESHOLD TESTS FOR OBTAINING AN EAPO

4.1. The FMLC supports the inclusion of a threshold test for obtaining an EAPO in Article 7 of the Presidency Compromise Text.[7] Article 8 could, however, be further clarified. Article 8 states that the creditor must submit a declaration that the information he/she provided in his/her application for an EAPO is "true and complete to the best of his knowledge".

4.2. This requirement may lead to issues of uncertainty and inconsistency. It is unclear whether there are any constraints on the knowledge requirement, since Article 8 does not provide any indication as to whether the courts should apply a subjective or objective test when determining whether a creditor used information that was "true and complete to the best of his knowledge". By way of illustration, English law recognises a variety of categories of knowledge. These include "actual knowledge", "constructive knowledge" and "imputed knowledge". A subjective test may determine what the creditor actually knew at the time of making the application and an objective test may determine what a reasonable person with the same general knowledge and abilities as the creditor would have known. The English legal system also adopts "wilful blindness" (i.e. "shutting one's eyes to the obvious") as the equivalent of

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6 Regulation no. 1346/2000.

7 Article 7 provides that for a court to grant an EAPO, it must be satisfied that the creditor is likely to succeed on the substance of its claim and that, without an EAPO, there is a real and imminent risk that funds may be spirited away, therefore frustrating enforcement of the creditor's claim.

"knowledge" in certain circumstances.[8] By way of further example, under the Finance Act 1975, "knowledge or belief" is given to mean the personal knowledge of the person required to prepare the accounts in question and includes any information contained in documents in that person's possession (see sch.4, paragraph 2(1)(b)).[9]

4.3. The application of a purely subjective test may set a low threshold which could lead to a proliferation of asset protection orders; this would create considerable operational difficulty (see section 7 of this paper for an outline of operational issues). The decision to set a low threshold to enable asset protection orders to be granted more easily is a question of policy which falls outside the FMLC's remit. If the Commission should wish to set a higher threshold as a matter of policy, it is recommended that an objective standard is incorporated into the test. To achieve this, the following suggested wording might be inserted after the words "to the best of his knowledge" in Article 8 of the Presidency Compromise Text: "*—including all relevant material, whether helpful or unhelpful to his case—having made reasonable and proper investigation*".

## 5. EXEMPTIONS

5.1. The FMLC welcomes the inclusion of Article 32 of the Presidency Compromise Text which stipulates that "amounts" which are exempt from seizure under the law of the Member State of enforcement should be exempt from preservation. It is, however, unclear how the meaning of "exempt" should be applied. By way of example, under English law, the question of an exemption from an asset protection order is at the discretion of the court granting the order having regard to all the circumstances.[10] In applying Article 32, it is not clear how discretion of this nature would operate when a foreign court is granting a preservation order. One solution to deal with this would be for the Proposed Regulation to set out whether the foreign court would need to

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8 In *Roper v Taylor's Central Garages (Exeter)* [1951] 2 T.L.R. 284, Devlin J. described this as "deliberately refraining from making inquiries, the result of which a person does not care to have".

9 Finance Act 1975: http://www.legislation.gov.uk/ukpga/1975/7/pdfs/ukpga_19750007_en.pdf.

10 By way of example, in the UK it is generally accepted that a court will look to ensure that a freezing order does not operate oppressively and a defendant will not be hampered in his/her ordinary business dealings any more than is absolutely necessary to protect the claimant from the risk of improper dissipation of assets.

replicate the judicial approach of the court of the Member State of enforcement.

5.2. In order to provide adequate protection for debtors, the provision for sums to be made available for normal living expenses and legal expenses should also be explicit in this article. In particular, if there is no specific provision in the Member State of enforcement for such matters to be decided separately from an application which the courts in that State are competent to hear, it should be made express that Member States can set up a stand-alone process for determination of these matters where an EAPO is being enforced. Otherwise, as things stand in English law it will be uncertain whether the defendant to an EAPO can get any relief of this sort, except from the issuing court which may result in the defendant suffering irreparable damage before any relief can be obtained. Further still, the relief available may be unsuited to the economic conditions in the Member State of enforcement given differences in living and business costs in different parts of the EU.

## 6. IMPLEMENTATION OF THE EAPO

6.1. Uncertainty arises from the absence of an express provision stipulating whether a bank may utilise its rights of set-off (indeed, such rights are automatically included within English asset protection orders). Set-off allows a bank to combine the accounts held by a customer, allowing the bank to transfer money from an account that is in credit in order to make payments due on another account.

6.2. If the Proposed Regulation is intended to permit a bank to exercise its rights of set-off and netting, (in accordance with other *ex parte* orders) this should be explicitly stated. By way of comparison, under the current English legal system where an asset protection order is served on a bank in respect of a credit balance, this does not give the party to whom it is granted any rights over the credit balance or alter priority between creditors, subject to a contrary provision in a particular order. An asset protection order in the standard form will contain a provision allowing a bank, when it receives notice of such an order in

respect of a customer, to exercise all rights of set-off that exist in the bank's favour over the credit balance of that customer. This right of set-off may be exercised in respect of interest accruing in the future, as well as interest which had already accrued at the date of notification (*Oceanica v Mineral Import, The Theotokos* [1983] 1 WLR 1294). No fresh rights can be created over the credit balance in the bank's favour, unless the asset protection order is discharged or suitably varied.

## 7. OPERATIONAL ISSUES

7.1. The FMLC understands the issues below have been drawn to the attention of Commission and/or HM Government. The FMLC observes that these issues are likely to cause significant operational difficulty for banks but also notes that any further consideration of such issues is beyond the scope of this paper.

### Security deposits

7.2. The Proposed Regulation does not require the claimant to provide a security deposit (or similar) to allow for compensation to be paid to the defendant if this should subsequently be deemed appropriate. This question would be left to the law of the Member State of the issuing court to determine (Article 12).[11] Such an approach may lead to variations between Members States, in their application of this provision.

### Declaration requirement

7.3. The proposed timescales envisaged for the implementation of an EAPO (Article 26) and declaration to be given by a bank (Article 27) may give rise to operational uncertainty. The timescales are very short and provide no flexibility or application process to allow a bank to obtain an extension under certain circumstances.

7.4. Operational uncertainty would also be increased if the requirement to provide a declaration created a conflict of interest for a bank, and if compliance with this

[11] Article 12 of the Proposed Regulation provides that the court "may require the provision of security or deposit or an assurance by the claimant to ensure compensation for any damage suffered".

provision made it necessary for a bank to breach a duty of confidentiality it had to its customer. Any purported breach may give rise to litigious claims.

**Identification of relevant accounts**

7.5. The FMLC notes that major operational difficulty might result from the obligation on banks to identify any accounts held by a defendant in a particular Member State (Article 17).[12]

## 8. CONCLUSION

8.1. The FMLC observes that the Presidency Compromise Text has gone some way to address the issues examined in the FMLC's previous letter on the Proposed Regulation. The FMLC takes the view that consideration and clarification of the points raised above are important in ensuring the creation of a robust procedure, for the freezing of a debtor's assets located abroad, which provides legal certainty to the wholesale financial markets.

[12] Article 17(5) of the Presidency Compromise Text creates an obligation for a defendant, by order of a body of the Member State of enforcement, to disclose accounts (and to refrain from disposal, withdrawal or transfer) which may be particularly onerous. Such a system may also be susceptible to abuse. The FMLC notes that it is not clear whether the necessary legal and administrative infrastructure exists for a undefined body in the UK to make an asset protection order against the debtor coupled with a disclosure order to consider the response and to serve it on banks or to enforce the order if no response is forthcoming.

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